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SUBJECT: CHELYABINSK OBLAST: SOUTHERN URALS REGION COPES WITH ECONOMIC HARD TIMES

Sensitive but Unclassified. Not for internet distribution.

¶1. (SBU) Begin Summary: Consul General, Public Affairs Officer, Department TDYer and LES Pol/Econ assistant traveled to Chelyabinsk and Magnitogorsk May 26-28. In Chelyabinsk, we met with the leader of the Pravoe Delo (Right Force) political party, toured an American investment and met with the American chief of the Emerson Electric corporation. In Magnitogorsk, the CG met the mayor while opening a photographic exhibit at the city art gallery. End Summary

Chelyabinsk political scene quiet

¶2. (SBU) In Chelyabinsk, we had lunch with city duma deputy Aleksey Sevastyanov, USG exchange program alum and current leader of the Pravoe Delo political party in Chelyabinsk. According to Sevastyanov, Pravoe Delo claims about 1500 members in Chelyabinsk oblast, with branches in Miass, Magnitogorsk and other cities. Entrepreneurs and small and medium business owners make up the bulk of the party's membership. The economic crisis has hit small and medium businesses the hardest, according to Sevastyanov, due to the lack of availability of credit. Some are being bought out by larger firms. Meanwhile, the government has been focusing its attention on assisting industrial giants such as Mechel and the Magnitogorsk Metallurgical Combinat (MMC) in weathering the crisis. Sevastyanov said that his group, which is pro-Kremlin in orientation, does not advocate any revolutionary ideas, but stands for the development of the rule of law, an end of corruption and opportunities for small businessmen.

¶3. (SBU) The current political scene is relatively quiet, with major elections just having occurred in March. Sevastyanov said that the region's young people are not politically minded and that pensioners, the segment of society most likely to protest, were recently mollified by the government's promise of a raise in benefits by 2010. He said that NGOs are not under any particular pressure in the region, but reiterated his complaint that Chelyabinsk Governor Sumin steadfastly refuses to appoint a human rights ombudsman.

American investors cope with economic downturn, other problems

¶4. (SBU) We traveled to the outskirts of Chelyabinsk to visit the Carbo Ceramics plant which manufactures ceramic propant used in the oil and gas industry. The Texas-based company invested over US\$ 42 million in the plant, which opened in 2007 and employs about 100 workers. The economic crisis has reduced demand in Russia, forcing the company to export more of its product to Europe and the U.S. But the high quality of Carbo's product still finds buyers among western firms doing business here such as Halliburton, Schlumberger and TNK-BP. The company has switched from using low-quality Urals bauxite to higher quality ore from other parts of Russia to maintain its standards of quality.

¶5. (SBU) Dinner with Dwight Bohm, American director of the Emerson Electric portion of the Emerson-Metran U.S.-Russian joint venture revealed both the potential and the pitfalls that

face American investors in Russia. The global economic crisis has ended a four-year period of steady growth for Emerson's business in Russia. Mr. Bohm expected that his company's revenues would reach only 2007 levels in 2009. He hoped that the company could maintain this level through next year, by which time he believed the economic crisis would be over. Emerson had not engaged in significant layoffs; to do so would be very risky in the context of Russian labor law. He allowed that the metallurgy industry in Chelyabinsk oblast was suffering and that cuts in employment would continue.

¶ 6. (SBU) Mr. Bohm revealed that Emerson was negotiating a buyout of its Russian partner. The main reason for this seemed to be the failure of the Russian side to fully comprehend the need for transparency and adherence to the high standards of business ethics maintained by the St. Louis- based Emerson corporation. A series of accounting irregularities, conflicts of interest in the supply chain and a criminal investigation of the principal Russian partner had taken their toll on the business relationship. Mr. Bohm lamented that the business culture and practices in Russia were simply not up to western standards. He allowed that the criminal investigation - about which he declined to elaborate - was the last straw and led to Emerson's takeover effort.

¶ 7. (SBU) In general, Mr. Bohm praised the attitude of the regional authorities to American investors, but noted that dealing with federal authorities was much more difficult and that lines of jurisdiction were often unclear. For example, Emerson's operation occupies space in a plant that once made equipment for the Russian Ministry of Defense, which remained its landlord. When confronted with a sudden massive rent increase year, the company was virtually without recourse. Though regional officials wanted to be helpful, they were unable to assist. Negotiations were unsuccessful in reducing the increase to a more reasonable amount. Carbo Ceramics managers echoed this theme, stating their plant is located on two parcels of land, one of which is controlled by regional and the other by federal authorities. They noted that regional authorities had been very accommodating in meeting the company's needs for infrastructure connections, but that federal authorities had been far less forthcoming.

Magnitogorsk welcomes photo exhibit

¶ 8. (U) In Magnitogorsk, we met mayor Yevgeniy Venianovich Karpov who joined in opening the PAS-produced photographic exhibition "My Discovery of America," which combines the work of a Yekaterinburg photographer and the poetry of Vladimir Mayakovskiy and drew large crowds and rave reviews in Yekaterinburg. Mayor Karpov, who rose through the ranks of MMC before his election as mayor in 2005, spoke proudly of his city's history and contribution to the Russian economy, but emphasized its lively cultural life and it's crown jewel - the European champion Metallurg professional hockey team. Karpov was open and friendly and raved about a recent trip he took to the United States as a tourist, visiting Las Vegas, Los Angeles and Hawaii. Karpov is one half of an unusual political power couple in Russia: his wife is a city duma deputy. Press coverage of the event was very positive.

¶ 9. (SBU) Comment: The bustling streets of Chelyabinsk gave the impression of a city that is coping reasonably well with economic stresses. Magnitogorsk looked a bit down on its luck, but a newly built cathedral gleamed on a hilltop overlooking the city's sprawling industrial complex. A superficial tour of MMC itself revealed an orderly operation. Our guide alluded to layoffs in the company, but would not give details. He commented that cutbacks in working hours that had been imposed earlier in the year had been rescinded and shifts were once again working five days per week. The important question facing MMC is whether it can produce steel of high enough quality to be competitive on the world market.

¶ 10. (SBU) Comment continued: The road connecting Chelyabinsk and Magnitogorsk was one of the best that we have travelled on in the region. It was in decent repair and had more stretches

of four-lane divided highway than we have seen elsewhere. We left the beaten track for Arkaim, located in the remote steppe of the southern Urals about 160 km from Magnitogorsk, where we visited the 18th century B.C. archaeological site of a former proto-civilization. Arkaim is one of several ancient city states in the region that are being investigated by archeologists. Though the actual excavations on the site are minimal, the location, which is sometimes touted as "the Russian Stonehenge," has become a popular destination for those seeking sources of cosmic energy and mystical healing powers. Our guide, a historian, while acknowledging that the site may have been constructed to allow observations of astronomical phenomena, downplayed the modern cult associations with the site. She emphatically stated that, despite the large crowds that gather there for the summer solstice, paganism has no place in modern Russia. End Comment

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